Investors were able to shake off a "Brexit" scare in late June to finish the quarter with modest gains in both fixed income and the broader stock market. While the S&P 500 returned 2.46% over the quarter to bring the year-to-date total return up to 3.84%, underlying sector and style performance was markedly uneven. For comparison, the NASDAQ composite, which is more heavily weighted to the traditionally higher growth Technology, Consumer Discretionary, and Healthcare sectors, has returned -2.66% year-to-date. We will share our thoughts on the divergent performance of growth and value stocks below. For fixed income, yields continued to grind lower throughout the quarter, as the odds of an interest rate hike in the near future faded to nearly zero. Municipal fixed income as measured by the Barclays Managed Money Municipal Short/Intermediate Index finished the quarter with a total return of 1.52%, bringing the year-to-date total return up to 2.88%. Taxable bonds, as measured by the Merrill Lynch US Corp/Gov't 1-10 Year A or Better Index, returned 1.33% over the quarter, bringing the year-to-date return up to 3.68%.

For fixed income markets, the second quarter was a story of the Federal Reserve and the Brexit. For the first two months of the quarter, market participants believed that the Federal Reserve would raise the overnight rate at the June meeting, given that economic indicators, while not robust, were strong enough to justify an increase. As a result, bonds traded in a tight range with the 10-Year Treasury trading between 1.57% and 1.92%. In early June, the Labor Department released the May employment report revealing an anemic 38,000 increase in nonfarm payrolls, far below consensus expectations of 160,000. The result was an immediate re-pricing of the Fed's next move, with the 10-Year dropping 10 basis points on the day and the implied odds of a rate hike by the end of 2016 dropping to nearly zero. On June 23rd, the world was shocked with the results of the referendum vote for Great Britain to leave the European Union (EU), a political/economic union of 28 countries which form a single market allowing for the free movement of goods, people and services. Like the reaction to May's jobs report, the response to the Brexit vote was strong and swift. The U.S. 10-Year Treasury dropped 30 basis points on the day, largely a function of investors' "flight to quality." This "flight to quality" has not only impacted the U.S. markets, but has resulted in negative sovereign yields throughout Europe and Japan, with over $11 trillion worth of bonds carrying a negative yield according to a report by Fitch Ratings. With global investors seeking safety, liquidity, and yield, U.S. Treasury yields are likely to remain anchored despite the Fed's intentions of normalization.

Given the interest rate environment, the trend that has dominated the equity market so far in 2016 has been the relative outperformance of the high dividend yielding sectors. Utilities and Telecoms have led the market higher with both sectors returning over 20% through the first six months of the year. The rally in these traditionally defensive sectors has not been fueled by fundamentals; rather, the hunt for yield has driven investors into these low-to-no growth sectors as a proxy for bonds. With the 10-Year Treasury yielding 1.47% as of 6/30 and trending lower, the roughly 4% dividend yield from some names in these sectors are attractive. These bond-proxy sectors typically are referred to as value plays; however, we would argue that the rise in the stocks of these companies has left them at anything but a value. By any number of valuation measures, the Utilities, Telecoms, and Staples are rich relative to the other sectors and their own historic valuation ranges. Should equity investors turn their attention back to fundamentals, as we suspect they will, companies with favorable relative growth profiles should come back in favor given their relatively cheap valuation levels.

The team at Appleton is constructive on both the equity and fixed income markets as we move into the second half of 2016. For the economy in general, accommodative central bankers are likely to continue to provide ample liquidity to the financial system, which should foster the conditions needed for modest economic growth. For bonds, the Fed is likely to err on the side of caution in their attempt to normalize interest rates with inflation likely remaining stubbornly low. Low to negative foreign sovereign yields are likely to anchor U.S. yields and continued strong demand for high quality, U.S fixed income is likely to keep interest rates low for long. For equities, merger and acquisition activity and corporate buybacks are likely to continue given the low interest rate environment. We expect corporate earnings to improve in the second half as the impacts from oil and the U.S. dollar turn from headwinds into tailwinds. The uncertainty surrounding the U.S. presidential election is likely to cause some volatility. However, following the election, we would anticipate a renewed call on Washington for fiscal stimulus as the influence of monetary policy fades. As always, the outlook is not without risks as valuation levels, the ongoing Brexit deliberation, the U.S. presidential race, any potential shock from the Chinese economy/currency, and general global growth concerns all have the potential to weigh on investors. The team at Appleton Partners will be mindful of these risks and how they could potentially impact your portfolio going forward.

As always, we welcome your comments and questions. Please contact us if there are any changes to your financial situation or investment objectives. Appleton is also now active on Twitter: follow us on Twitter at @AppletonPtnrs.